STATEMENT OF THE INDEPENDENT INSURANCE AGENTS OF AMERICA
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
FINANCIAL SERVICES COMMITTEE
UNITED STATES HOUSE OF REPRESENTATIVES

August 1, 2001

Good afternoon Chairwoman Kelly and Members of the Subcommittee. My name is Tom Ahart, and I am pleased to have the opportunity to give you the views of the Independent Insurance Agents of America (IIAA) on some of the problems we have experienced related to state regulatory oversight of the rates charged for automobile insurance in the personal lines market. I am President of the Ahart, Frinzi & Smith Insurance Agency in Phillipsburg, New Jersey. I also am a member of the IIAA Executive Committee, and I will become President of the IIAA in October of this year.

IIAA is the nation's oldest and largest national trade association of independent insurance agents, and we represent a network of more than 300,000 agents and agency employees nationwide. IIAA members are small businesses that offer customers a choice of policies from a variety of insurance companies. Independent agents offer all lines of insurance – property, casualty, life, health, employee benefit plans, and retirement products.

Introduction

At the outset, Chairwoman Kelly, I must note that IIAA welcomes this Committee's efforts to analyze and assess the challenges that face our state-based system of insurance regulation. It is our expectation that this will be the second of a series of hearings, and we hope we will have the opportunity to present our views at each and every stage of your deliberations on these crucial questions.

If given this opportunity, one overarching theme that you will hear from us repeatedly is our desire to modernize and harmonize existing state insurance regulatory systems and to make regulatory requirements more uniform across state boundaries. At the same time, we recognize that, in many respects, insurance remains an inherently local business and that any system of insurance regulation must be flexible enough to accommodate differing local, state and regional needs and circumstances.

Last month, Chairman Baker's Subcommittee held a hearing examining the manner in which states currently oversee and approve insurance products, and the hearing brought to light many of the inefficiencies, idiosyncrasies, flaws, delays, and redundancies associated with the existing system of oversight and review. Many of these same problems are evident in the regulation of personal lines automobile insurance rates, an area of regulation that is in many cases wrought with inconsistent state requirements and excessive government interference.

A recent study on property-liability insurance price deregulation, published in April of this year by the American Enterprise Institute-Brookings Institution Joint Center for Regulatory Studies, describes the current state of regulation in this area:

> Automobile insurance prices are currently regulated in forty-nine States. In thirty-one States, the regulation is of the *prior approval* variety, meaning that insurers must file rates with the state insurance commissioner and have them approved before they can be used in the market. In the other States, insurers can change prices without prior approval, usually with the proviso that they file the rates with the insurance commissioner, who can subsequently disapprove the rates. Only Illinois does not allow disapproval.

Extensive rate regulation in States like New Jersey and Massachusetts is motivated by the political desire to minimize insurance rates. According to the AEI-Brookings study, however, "[s]tate regulation of the $120 Billion annual auto insurance market does not significantly decrease prices for consumers" but instead "generally reduces the availability of coverage and increases price volatility." Moreover, as the authors of the AEI-Brookings study conclude, "there is no evidence that prices or profits in States that rely on markets to set rates are excessive or that insurers behave collusively."

At the same time, as the AEI-Brookings study also recognizes, rate regulation "often results in rate suppression, meaning that the total amount of premiums collected in a State is less than would be collected under competition, resulting in a decline in the market value of insurer equity." Indeed, in Massachusetts and New Jersey, dozens of automobile insurance carriers have withdrawn from the automobile insurance markets over the course of the last two decades because the approved rates for automobile insurance coverage in these States have been grossly inadequate. In a competitive economy such as ours, insurance companies cannot be required to lose money. In Massachusetts and New Jersey, however, the only effective alternative with respect to automobile insurance is to abandon the market completely.

In the short term, such over-regulation presents a tremendous opportunity for independent insurance agents because, in times of market turmoil, we protect consumer interests by ensuring that their automobile insurance coverage is placed with a qualified carrier that intends to continue offering personal lines automobile insurance products in these States. Independent agents are situated uniquely, because we have the authority and expertise to move a customer's coverage from a withdrawing insurer to the best available alternative coverage package quickly, as soon as the initial insurer's plans to withdraw become evident.

In the long term, however, consumers suffer because these insurance markets are under-served and because drivers with better driving records and those that live in lower exposure areas subsidize other drivers throughout a more heavily regulated State. As the AEI-Brookings study notes, rate regulatory systems like those in New Jersey and Massachusetts "subsidize[] high-cost drivers [those likely to have the most accidents], sending adverse incentive signals and increasing accident costs." According to the authors of the study, such regulation thus "creates material economic inefficiencies in order to provide subsidies to the drivers who impose the highest costs on state automobile insurance systems." As the study also recognizes, consumers also suffer when the insurance market is strong overall because "[i]nsurers are reluctant to reduce prices in regulated states, even when premiums are high relative to expected costs, out of concern that they will not be able to raise premiums again if cost inflation accelerates." In addition, insurance agents suffer in the long term because there are fewer products to offer to their customers.

At the same time, rates that will be viewed as adequate vary from State to State with the specific conditions of their respective marketplaces. For example, because the automobile theft rate in Topeka pales in comparison to the theft rate in Newark, and because the population density in New Jersey greatly exceeds the population density of Kansas, the insurance costs in those two locales vary significantly.

The challenges that any reform effort in this context must overcome are thus significant. My testimony today will focus primarily on the problems that we are facing in two States in which the rate regulatory environment is particularly onerous – my home State of New Jersey and the Commonwealth of Massachusetts. In both of these States, the intrusion and excessive intervention of regulators into the setting of personal lines automobile insurance rates effectively means that pricing is not responsive either to market conditions or to the circumstances of individual drivers in any way. This has resulted in the mass exodus of many carriers from the personal lines automobile insurance marketplace in both States. In Illinois and South Carolina, in contrast, reforms to the personal lines automobile insurance rate oversight process have resulted in the entry of dozens of new carriers into each marketplace and in the reduction of insurance costs for many drivers.

New Jersey

For well over twenty years, New Jersey drivers have paid the highest auto insurance premiums in the country. State officials were hopeful that a series of statutory reforms enacted in 1998 – including a provision that mandated a 15 percent across-the-board rate reduction – would ease automobile insurance premium levels.

The centerpiece of New Jersey's automobile insurance rate regulation is its requirement that no carrier may change the premiums on the automobile insurance policies it offers without affirmative approval of the change by the New Jersey Commissioner of Insurance. After a request is filed, it generally takes at least 6 to 12 months for the Commissioner to make an initial ruling. The Commissioner has not, however, granted a significant rate increase request in recent memory, and the last several Commissioners refused to grant any increases at all during an election year. Moreover, although a carrier that has been denied a requested rate increase can appeal that decision to an administrative law judge, the decision of the judge is non-binding, and no rate change denial ever has been overturned on appeal to the New Jersey Supreme Court.

This onerous process is coupled with two regulatory requirements that have proven to be particularly burdensome. First, although insurance carriers are not guaranteed any profits, they are prohibited from earning more than 6 percent in profits from their sales of automobile insurance policies over any three-year period. If a carrier does earn more than that percentage in profits, it is required to return the "excess" profits to its insureds. There is no allowance or make-up if the carrier lost money prior to the start of the three-year period in which it performed well.[1]

Second, carriers are required to "take all comers," meaning that they are required to insure any licensed New Jersey driver that applies for coverage. Because of the difficulty in raising rates under the State's procedures, drivers with good driving records inevitably subsidize those without paying higher premiums to make up for the shortfall.

While automobile insurance rate reform always has been a high-profile issue in New Jersey, it was not until the State's 1997 elections that state leaders witnessed widespread voter discontent. In the weeks and months preceding the election that fall, polling data showed that residents were unhappy with their leaders' inability to reduce automobile insurance premiums.

Not surprisingly, the 1998 session was the most serious attempt to reform the automobile insurance system in many years. Attempts at auto insurance reform, however, were nothing new for New Jersey. In the early 1970s, the State implemented a verbal threshold, no-fault mechanism to help reduce the costs associated with excessive litigation. With the no-fault option (which is accepted by 88 percent of New Jersey motorists), medical payments are made regardless of fault and the need for litigation is reduced. Victims can sue for pain and suffering damages if they suffer a "serious" bodily injury or a certain specified injury. This verbal threshold was intended to limit the right to sue to cases involving serious injuries, such as dismemberment, loss of bodily function, and similar severe damages. Instead of stabilizing the cost of liability claims, however, costs increased 34% from 1989 to 1996 while the average state premium increased only three percent.

After joint legislative hearings on the issue were held in 1998, separate versions of the automobile insurance reform legislation made their way through the State Senate and Assembly. The process was complicated and controversial from the start, and one insurance industry observer suggested that the movement of the bill resembled a "ping-pong match" between the two chambers and the governor. Eventually, after a conditional veto from the governor, a legislative package reforming the existing no-fault system was agreed to and signed into law.

The centerpiece of the new law is a mandatory 15 percent reduction in automobile insurance premiums. For the average consumer, the 15 percent required rollback will mean an annual savings of about $165 to $180.

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1 In contrast, according to the American Legislative Exchange Council, insurance laws in the following seventeen (17) States dictate that insurance departments cannot find insurance rates excessive if the insurance market is a competitive one: Arkansas, Connecticut, Delaware Georgia, Idaho, Illinois, Indiana, Kentucky, Michigan, Missouri, Montana, Nevada, Oklahoma, Oregon, Vermont, Virginia and Wyoming. In addition, insurance laws in the following five (5) States dictate that rates are "presumed" not to be excessive if there is a reasonable degree of competition: Arizona, Kansas, Minnesota, New Mexico and Wisconsin.

In order to justify the 15 percent savings, the 1998 law included numerous provisions intended to reduce current costs. Most notably, the law attempted to tighten "no fault" rules to limit pain and suffering lawsuits. The law also purported to repeal the State's territorial rate requirements. This provision, however, has not been implemented even though it was scheduled to go into effect by January 1, 2000, when the 27 existing territories were required to have been redrawn. Even under the repeal, the insurance commissioner retains the ability to deny rate increases that affect urban drivers in a "significantly disproportionate" manner, a term that has never been defined.

Although the 1998 law contained some favorable cost saving reforms, the industry consensus is that these do not come close to realizing the 15% reductions in premiums that the law required. Indeed, the 15% rollback appeared to be based on an arbitrary figure, with no connection to the law's likely impact. Independent studies have been conducted that support this contention by suggesting that the resulting cost savings are unlikely to exceed 3-5 percent.

At the time, independent agents in the New Jersey were hopeful that the new law would help build upon the gradual improvements made to the New Jersey automobile insurance market over recent years. At the same time, we recognized that we would play an essential role in the implementation of the law, as consumers would turn to us for advice, guidance, and clarification about their policies and the impact of the new law. We also recognized that, even under the best case scenario, many drivers would assume that their insurance costs would automatically drop by 15%, but they all would not receive such a reduction.

Unfortunately, enactment of the 1998 reforms has not resulted in the "best case scenario" but has instead led to the departure of carriers who formerly counted among their insureds over 25 percent of all New Jersey drivers. The reasons for this mass exodus are at once numerous and hard to pinpoint. The uncertain rate environment, the shear expense of participating in the rate-making process, the virtual impossibility of obtaining adequate rate increases, and the "take all comers" requirements all appear to have contributed to the reluctance of carriers to continue their participation in the New Jersey automobile insurance marketplace. In addition, the number of carriers abandoning the New Jersey automobile insurance market might have been *greater* if withdrawing insurers were not required to give up their licenses to offer all types of property-casualty insurance within the State if they choose to withdraw from the personal lines automobile insurance segment.

Massachusetts

Although the rate-setting process in Massachusetts is quite different than that in New Jersey, the outcome has been largely the same.

In Massachusetts, the maximum automobile insurance rates for all carriers are established globally in an annual adjudicative proceeding. In August of each year, the Massachusetts Automobile Insurers Bureau files a single petition on behalf of all carriers offering automobile insurance coverage in the State to establish rates that will apply to all such carriers. In early September of each year, the State Ratings Bureau and the Massachusetts Attorney General file papers challenging the requested rates on behalf of Massachusetts drivers. A full trial-type hearing is then held over the course of the next several months during which all parties make presentations, present testimony and cross-examine each others' witnesses. At the conclusion of these proceedings, the Insurance Commissioner sets the rates.

Although carriers can and do deviate from these rates by offering discounts to safe drivers and through group marketing arrangements, the system – like New Jersey's – still fosters incredible rate uncertainty and results in good drivers subsidizing the rates of bad drivers and experienced drivers subsidizing less experienced drivers. Many carriers responded by fleeing the Massachusetts automobile insurance market in the mid-1980s, and, to the detriment of both consumers and insurance agents, there have been essentially no returnees or new entrants in the intervening two decades. As in New Jersey, the number of carriers withdrawing from this market might have been even greater if such carriers were not also required to give up their ability to offer any type of property-casualty insurance in Massachusetts if they withdraw from the automobile insurance segment.

South Carolina

Until recently, the automobile insurance market in South Carolina resembled that of New Jersey and Massachusetts. Mandatory pre-approval of all rate changes and a "take all comers" requirement resulted in a continual erosion of the number of carriers serving that market and imposed higher insurance costs on many South Carolina drivers.

All of that changed in March 1999, when South Carolina's new rate deregulation law went into effect. Under that new law, carriers may increase or decrease automobile insurance rates in any given year by up to 7 percent without any prior approval whatsoever, and they may amend their rates by a greater percentage under a much more liberalized and predictable "file and use" system. These "flex rating" and "file and use" regulations allow carriers to begin using their proposed rates as soon as they are filed with the state insurance department, and they generally give the Insurance Commissioner only a limited window of time during which to challenge usage of the proposed rates.

Within two years, South Carolina drivers were paying on average $80 less per year for their automobile insurance policies, and South Carolina had dropped from 26th in the nation in automobile insurance rates to 38th. The ability to underwrite each driver individually (and thus to provide non-standard coverages to non-standard drivers), the new pricing certainty, and the elimination of the uncertainty of the rate approval process have helped contribute to the entry of over 100 new carriers into the South Carolina automobile insurance market and generate the resulting declines in the price paid for automobile insurance.

Illinois

At one time, Illinois had a very highly regulated automobile insurance market and, like New Jersey and Massachusetts, it experienced very high rates and the departure of a significant number of carriers. In the mid-1970s, Illinois completely deregulated its automobile insurance rate approval structure and adopted a free-market pricing system. Despite the fact that Illinois is a highly industrialized State with a large urban center, the premiums Illinois drivers pay for automobile insurance are consistently ranked in the middle among all the States, and the Illinois automobile insurance market is served by as many automobile insurance carriers as any other State.

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Thank you for giving me the opportunity to express IIAA's views. We look forward to working with the Subcommittee on this issue and I will be happy to take any questions you may have for me.